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Dear Fellow Alaskans:

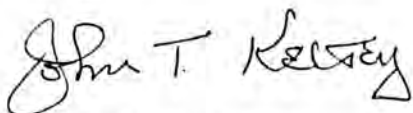
In the fall of 1994, the Alaska Permanent Fund Corporation mailed a short questionnaire to everyone who received a Permanent Fund dividend. We asked you what you planned to do with your dividend checks. We also invited you to tell us: "What does the Alaska Permanent Fund mean to you and/or your family?"

The response was overwhelming. More than 30,000 of you filled out the questionnaire and mailed it back to us. Thank you. We were pleased to hear from so many of you. We were also struck by the very personal impact and significance that these dividends have in your lives.

Two messages came through loud and clear: First, you overwhelmingly support the Permanent Fund. Second, the vast majority of you really appreciate receiving the dividend—and you put it to good use.

We promised you that we would share the results of our questionnaire. This booklet summarizes the responses by various categories and presents a wide spectrum of representative comments from Alaskans from all over the state.

The booklet, along with a companion video, has been produced as part of the Alaska Permanent Fund Corporation's ongoing public education efforts. Its distribution will include the Alaska Legislature, administration officials and other decision-makers, as well as public and school libraries and teachers and students throughout the state.

A handwritten signature in dark ink, reading "John T. Kelsey". The signature is fluid and cursive, with the first name "John" being larger and more prominent than the last name "Kelsey".

John T. Kelsey, Chairman
Board of Trustees

'We have saved all Permanent Fund dividends for the last 10 years to fund our children's education at the University of Alaska. Without the dividend, we would not be able to finance their college education.'

'My husband passed away July 11, 1994. So it will come in handy on various things.'

'Dividends represent 1/6 of my family's gross income, without which we would have to join the welfare rolls, or leave bush Alaska altogether.'

'We will go to Mexico for Christmas and help paint an orphanage.'

'It is a leftover from a bygone era. As state revenues decline and we can no longer maintain our state infrastructure, it will become an embarrassment.'

'Much will go to pay for the birth of our last child.'

'The Permanent Fund signifies pride to me. The way Alaska manages its savings account is a model to all other states on fiscal management.'

'I favor capping the dividend at \$500. We have a responsibility to carry our fair share.'

'My job doesn't pay much, and I live check to check. The Permanent Fund Dividend helped pay for some dental work and car repair.'

'I could do without it if it would help the state.'

1. What do you plan to do with your Permanent Fund dividend this year?

☐ spend it

☐ save it

☐ spend some/save some

One-third of the respondents planned to spend all of their dividend check.

Nearly two-thirds of Alaskans planned to save at least some of the checks.

One-quarter planned to save all of their check.



'Our family has a rule that whatever we spend the dividend on, it must be spent locally.'

'Every year I've bought something I needed for my home, which is 53 years old. So far I've bought a refrigerator, freezer, couch and swivel rockers, adjustable bed (I'm disabled), dinette set, oil drum, washer and dryer, electric range, carpet, clothes and food. I am a widow of 22 years, 7 months.'

'Dinners out.'

'Of our three dividends, one will be used to pay off a current student loan, a second will be put towards our son's future education and the third put towards retirement and daily cost of living.'

'This year it helped buy windows to finish our addition. We will have light this winter instead of a boarded up hole.'

'I'm four years old. My parents gave me 1% of my dividend (almost \$10!) to spend carefully on what I want. Fifty percent goes to my future education, and 49% goes to living expenses and hopefully a family vacation.'

'I love the Permanent Fund, but I oppose the dividend program. Every year since 1982 I have given 100% of my dividend to charities in Alaska.'

'During the Alaska economic downturn in the late '80s, the dividends literally kept me afloat. Now that I am working steadily, I endeavor to save the money for the next financial downturn.'

2. If you plan to spend some of your dividend, how much will you spend in Alaska?

☐ all

☐ some

☐ none

More than three-quarters of the dividend spenders planned to spend all of their dividend in Alaska.

More than 95% planned to spend at least some of their check in Alaska.

Only 5% did not plan to spend their dividend in Alaska.



'I have received the Alaska Permanent Fund since the beginning and have saved every one. Now I am using the money to pay my own way through college. The Permanent Fund has given me a lot of independence and pride.'

'I am a senior citizen, and I am saving the fund for the time when I will need daily care.'

'It means we can pay our property taxes without going into debt.'

'I believe the dividend should be stopped until the future economic picture for Alaska becomes clearer. Only selfish wimps are afraid to give up a little now when it certainly means a much brighter future.'

'Means a way to pay for health care for those of us who are uninsured and don't qualify for medicaid.'

'My dad is unemployed. This pays bills while he looks for a job.'

'I like the inherent democracy of the system and the way it ensures that all Alaskans benefit directly from our oil money.'

'It is a part of our budget. It pays for fuel to keep us warm, or new tires for the car to keep us safe, college and retirement savings for security, and some years cheap airline tickets to keep us in touch with family.'

'It has allowed me to stay home with preschoolers instead of going to work.'

3. If you are going to save some of your dividend, approximately what percentage will you save?

☐ 10%

☐ 25%

☐ 50%

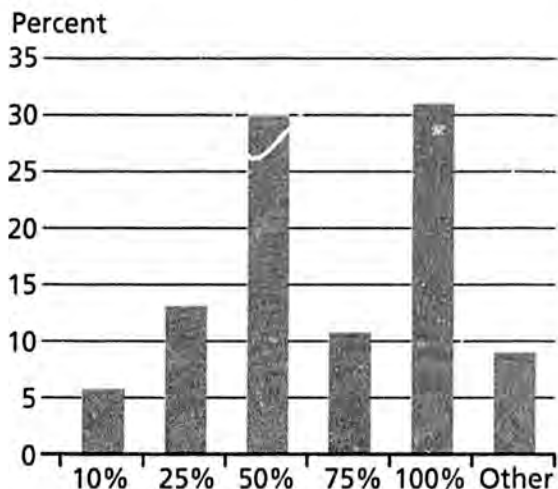
☐ 75%

☐ 100%

☐ Other _____

Of the two-thirds of all respondents who planned to save at least some of the dividend, 31% planned to save all of it.

More than three-quarters planned to save 50% or more.



'My daughter's Permanent Fund is an exceptional way to save for her college education. She was born here in 1991, and we have been saving and investing her dividend for her future.'

'In a normal year, I save the majority of it for retirement. This year, unfortunately, it all goes to a lawyer.'

'The Permanent Fund allows me to share Alaska with others from the Lower 48.'

'Dividends give people a piece of the action and are essential to maintaining interest and a general awareness of the Fund, but should be capped at \$750.'

'Seems a healthy way to recycle dollars in our state.'

'As a retiree and being fortunate to have assets that meet my needs, this money allows me to be more generous in supporting the library, museum, social programs, etc.'

'This year our dividends gave us a chance to take our terminally ill child outside for a vacation, not our quarterly trips to Seattle for treatment! We want him to know what real vacations are like and to enjoy his shortened life. Thank you.'

'It helps us make an extra house payment every year. It means some savings in the bank to help make ends meet when my husband gets laid off in the winter. (He's a carpenter).'

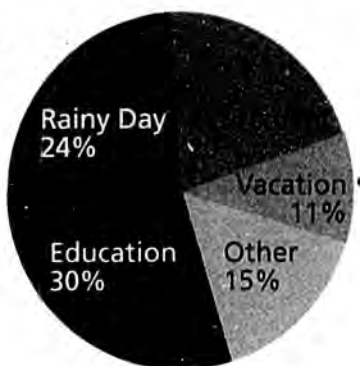
'Every year we travel in the RV to interior Alaska, and the travel expenses for ferries, gasoline and campgrounds come partly from the dividend checks.'

4. If you plan to save some of your dividend, what are you saving for?

- ☐ vacation ☐ education
☐ retirement ☐ rainy day ☐ other _____

Education (30%) was the primary savings goal of Alaskans.

Saving for a rainy day (24%)
and retirement (20%)
were also top choices.



'Cabin fever reliever. Otherwise I'd beat my husband, kick my kid and shoot the dog.'

'Airfares from the village to Fairbanks to visit the heart doctor.'

'A nice windfall at the end of the work season—appreciated more if work was not so plentiful. I would like to see a percentage go to a health plan for all Alaskans.'

'A chance to be independent of my children.'

'It means the University of Alaska system is physically decaying and academically struggling for survival. It means very young children do not get the proper medical care or education/child care.'

'We will be able to spend Christmas with my elderly parents, thanks to the checks and the airline plan.'

'I feel the Permanent Fund says thank you for giving of ourselves to help Alaska be the great state it is.'

'It helps me get closer to owning my own place to live.'

'I am 69 years old. This dividend helps me with my winter electric bills, needed service on my old car and a little something at Christmas for my four grandchildren. I am so very grateful to my state.'

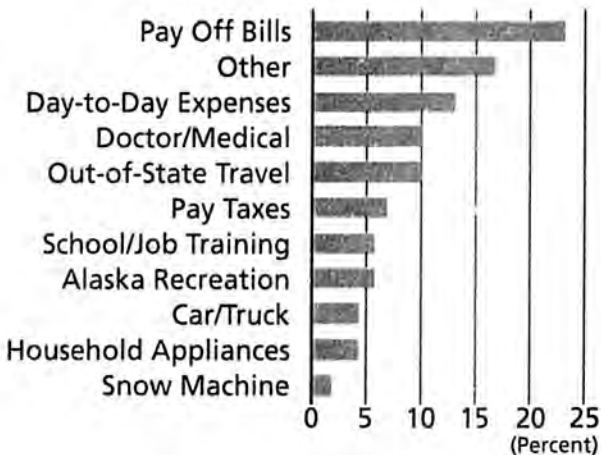
'The dividend means a lot to me. I have been receiving it as long as it has existed. This is money real Alaskans can count on, and I want it protected for our children's future.'

5. If you are going to spend some or all of your dividend, what are you planning to spend it on? (CHECK ONE OR MORE)

- ☐ snow machine/three-wheeler/boat/plane
- ☐ household appliances (including TV/stereo)
- ☐ doctor/medical
- ☐ Alaska recreation
- ☐ out-of-state travel
- ☐ pay off bills
- ☐ pay taxes
- ☐ car/truck
- ☐ school/job training
- ☐ day-to-day expenses
- ☐ other _____

Nearly 45% of dividend spenders planned to pay off bills or meet day-to-day expenses with their check.

10% each cited medical expenses and out-of-state travel.

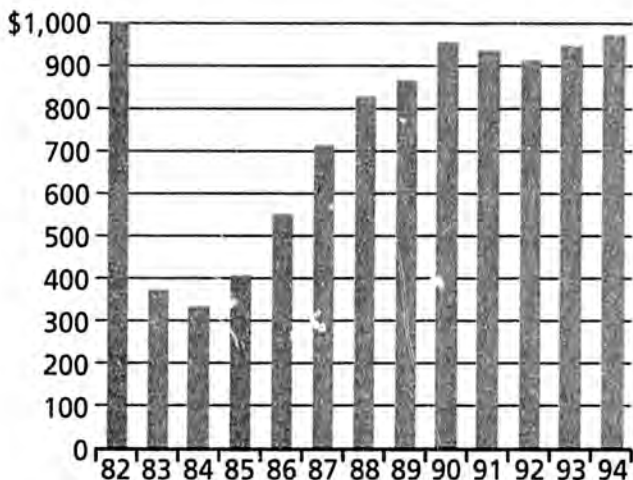


A few facts about the economic impact of Permanent Fund Dividends

- Since its inception in 1982, the dividend program has put \$5 billion directly into the pockets of Alaskans.
- In 1994, \$527 million was paid out to 535,000 Alaskans.
- An Alaska family of four receiving dividends for the past 13 years has received more than \$39,000 in Permanent Fund Dividends.

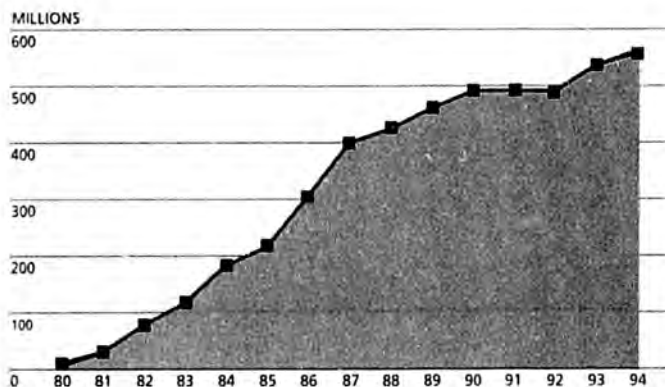
Per capita dividends

Since Inception



- The dividend program brings more new money into Alaska's economy each year than the total payroll of every industry except the petroleum industry and U.S. government spending.
- Dividends make a greater cash contribution than wages paid by construction, fishing, tourism or timber.
- Using a conservative multiplier of 1.5, spending of dividends indirectly creates 13 Alaska jobs for every \$1 million distributed.
- In 1994, the \$527 million distributed as dividends led to the creation of 6,800 Alaska jobs.

Fund income paid out for dividends



'I broke off a visible tooth in July. I am in no pain, but I am very self-conscious about smiling. Without the Permanent Fund, there would have been no way for me to ever afford to have it fixed.'

'With the dividend, I can contribute more to charity and help more people in need.'

'I think it is foolish to have income tax, no sales tax (in some large communities), distribute dividends, pay longevity bonuses and lay off 22 teachers, claim that road repairs are too expensive for us to go on using studded tires, and send Alaska prisoners Outside. We are becoming irresponsible legislators and citizens. Wake up and smell the coffee, Alaska!'

'The Permanent Fund means I get to live in a state I love and still get to see my family in Florida.'

'I live on a very limited income, and each fall it is spent on topping off the fuel tank, tuning the furnace, etc. It greatly lessens the financial burden of winter in Fairbanks.'

'I am three years old, and my parents save my PFD every year to pay for college when I grow up. P.S. My mommy wrote this for me.'

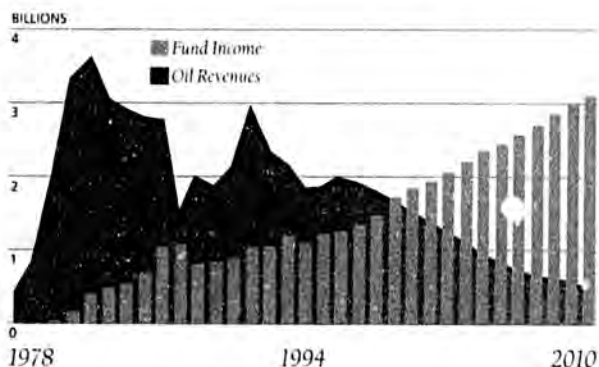
'We look forward to receiving it—but I do feel guilty that we in Alaska contribute so little to the state coffers.'

'We definitely would remain in Alaska with or without the dividend. We arrived in 1961. But I am very proud of our state for the decision to invest and manage this bonanza of sudden wealth so wisely for the benefit of all of us.'

How the Permanent Fund works

- Although Fund principal cannot be spent without a vote of the people, your elected representatives determine how the Permanent Fund's earnings are used. To date, the legislature has basically decided on two uses: dividends and inflation-proofing. In the future they may come up with other uses.
- For now, though, half of the Fund's earnings, averaged over the past five years, are earmarked each year for dividends.
- Inflation-proofing makes sure that our savings account maintains its value over time. How it works is: If inflation eats up \$300 million of the Fund's value in any one year, then \$300 million from that year's earnings go back into the Fund to offset the loss in value. It is a simple program, and it works.
- The assets of the Permanent Fund are managed prudently and conservatively by an independent corporation with its own Board of Trustees.

Permanent Fund income and state oil revenues



Record number of Alaskans want to learn more about their Permanent Fund

The 1994 dividend survey invited Alaskans to learn more about their Permanent Fund by sending for additional information. The 1994 Annual Report; An Alaskan's Guide to the Permanent Fund; Permanent Fund & State Resource Development Timeline Poster; and the CD-ROM Multimedia Guide to the Alaska Permanent Fund were offered to Alaskans free of charge.

For the first time, the Permanent Fund Corporation this year was able to provide its educational materials in either printed form or in an electronic, computer-based format on 3-1/2" diskettes or CD-ROM. The cost to the Corporation of producing and mailing the electronic material was less than for the printed materials.

More than 10,000 Alaskans requested additional information about the Permanent Fund. Of those who asked for publications, a majority asked for their information on diskette (IBM or Mac) or CD-ROM (MAC only), while the rest requested printed information.



This publication was released by the Alaska Permanent Fund Corporation in February 1995. The cost per copy was \$1.22. The booklet was designed and produced by Northwest Strategies and printed on recycled paper by Alaska Printing in Anchorage, Alaska.



801 W. 10th St., Suite 302 • Juneau, AK 99801

Mailing Address: P.O. Box 25500 • Juneau, AK 99802-5500

Juneau Phone (907) 465-2047 • Fax (907) 586-2057

Anchorage Phone (907) 277-1496 • Fax (907) 276-1691



Alaska Permanent Fund Corporation

P.O. Box 25500 Juneau, Alaska 99802-5500

(907) 465-2047

Memorandum

DATE: June 19, 1995

TO: Melissa Fouse, Long-Range Financial
Planning Commission

FROM: Jim Kelly, Research & Liaison Officer 

RE: **Material for LRFPC Members**

Melissa, please find attached a copy of the Executive Summary of the "Final Report of the Commission on the Future of the Permanent Fund" dated January 31, 1990. I am forwarding a copy to you at the request of our board chairman, John Kelsey, and would request that you forward it on to your members. It is an important part of the public record regarding the Permanent Fund.

Also, thanks again for placing us at the beginning of the Agenda the other day. Your willingness to accommodate us was much appreciated.

C: Byron I. Mallott, John Kelsey



Alaskans on the Future of the Fund

Final Report
of the Commission
on the Future
of the Permanent Fund

January 31,
1990

The Commission on the Future of the Permanent Fund

Representative H.A. "Red" Boucher, Chair

Representative Terry Martin

Senator Jan Faiks

Senator Steve Frank

**Hugh Malone
Commissioner of Revenue**

**John Kelsey
Chairman, Permanent Fund Corporation**

**Susan Burke
Public Member**

**Lance Parrish
Public Member**

**David Van Amburg
Public Member**

Supporting Staff

**Fate Putman
Ann Seidl
John Sivertsen, Jr.
S J. Klein**

**Commission Coordinator
Administrative Assistant
Researcher
Assistant Researcher**

Report Preparation

**Professor Larry Pearson
Professor Anthony T. Nakazawa
Professor Clive S. Thomas**

**Editorial oversight and design
Questionnaire analysis
Questionnaire analysis**

In 1989 the Legislature established the Commission on the Future of the Permanent Fund to gather public testimony, report its findings and make recommendations to the Governor and the Legislature.

Executive Summary

The Commission held 10 public hearings between September 30 and December 9, 1989, across the state. More than 200 members of the public and expert witnesses testified. The commission also gathered written testimony and reviewed legislation and documents pertaining to the Permanent Fund.

The public clearly stated it:

- **wants the Permanent Fund dividend retained,**
- **wants the principal of the Fund preserved,**
- **believes current levels of state spending are too high,**
and
- **does not want Fund earnings used to support State programs in the foreseeable future.**

Included in this report are the recommendations of the Commission suggesting statute modifications designed to preserve the value of the Fund and assure a stable flow of earnings.

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Questions facing us today

Since 1986, when the price of oil dramatically decreased, a number of Alaskans have become concerned about fiscal policy, sources of state revenue and the role of the Permanent Fund in Alaska's future. The Commission on the Future of the Permanent Fund was established by the 1989 Legislature to determine the appropriate response to such concerns. The Commission focused on two central questions:

- 1) What is the purpose of the Fund?
- 2) What role will it play in Alaska's long-term economic future?

The Commission was instructed to gather public testimony concerning the Permanent Fund, to report its findings and to make recommendations to the Governor and the Legislature. The Commission consists of nine members: two state representatives appointed by the Speaker of the House, two state senators appointed by the President of the Senate, three members of the public appointed by the Governor, the Chairman of the Board of Trustees of the Alaska Permanent Fund Corporation and the Commissioner of the Department of Revenue.

As part of its charge to gather public testimony, the Commission conducted ten meetings around the state, including two in each judicial district and two statewide hearings that were held in Anchorage and Juneau. To allow as much public participation as possible, the hearings were held on Saturdays. The Commissioners asked the witnesses questions to determine their opinions on specific issues.

The first years of the Permanent Fund

Alaska's voters approved the creation of the Permanent Fund in 1976. They accepted an amendment to the Alaska State Constitution as proposed by Governor Jay Hammond and passed by the Legislature. That amendment states:

At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses re-

ceived by the State shall be placed in a permanent fund, the principal of which shall be used only for income producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

—Alaska State Constitution,
Article IX, Section 15

Witnesses asked the Commission questions concerning the Permanent Fund, the dividend program, inflation-proofing, the Educational Endowment, the budget, income tax and long-term fiscal problems facing the state. As a hearing progressed, people commented on the issues presented by previous speakers and thus each hearing became a public forum for discussion of problems facing the state and the Permanent Fund.

As part of its charge to make recommendations, the Commission also heard testimony from the staff of the Permanent Fund Corporation and other expert witnesses, and reviewed documents pertaining to the Permanent Fund.

The Commission also prepared and distributed an eight-page handout about the Permanent Fund and the Commission. The handout contained a three-page, self-addressed questionnaire so that persons who either did not feel comfortable with public speaking or were unable to attend the public hearings could express their opinions. These handouts were used in presentations to high school and college government classes, senior citizen groups, Chambers of Commerce, Rotary Clubs and other civic groups.

(Summary of responses is provided in Appendix A. Copy of handout is provided in Appendix B.)

Since the adoption of this amendment, the Legislature has increased the deposit requirement to 50 percent for all mineral lease rentals, royalties, royalty sale proceeds, net profit shares and federal mineral revenue sharing payments received on leases issued after Dec. 1, 1979, and 50 percent of all bonuses received on leases issued after Feb. 15, 1980. (Alaska Statute 37.13.010 (a)(2))

Additionally, the Legislature provided that a portion of the income of the Fund shall be deposited into the principal to offset the effects of inflation as measured by the change in the calendar year average of the U.S. Consumer Price Index. (Alaska Statute 37.13.145)

The Permanent Fund's principal, estimated to be \$9.3 billion (\$9,267,975,000.00) on Nov. 30, 1989, has come from three sources:

\$3.659 billion had been deposited by that date as a direct result of the constitutional amendment and statutes, \$1.645 billion had been deposited to preserve the principal against inflation and \$3.964 billion had been placed into the Fund by three separate legislative appropriations.

What the public said

Four recurring themes emerged from the testimony of the 223 people who appeared at the Commission's hearings, the 71 people who submitted written testimony and the 1,132 who returned the questionnaires:

- **Retain the Permanent Fund dividend.**
- **Preserve the value of the Fund for future generations.**
- **Reduce state spending.**
- **Do not use Fund earnings in the foreseeable future to support State programs.**

Here is a summary of the testimony on these and related subjects:

Protect the principal of the Permanent Fund

While a few people testified that the Fund's principal should be divided equally among current Alaskans, the large majority supported protecting the principal. There was little support for the use of fund principal for in-state investments, economic development, infrastructure, or other non-income producing projects. The public believes that the current investment scheme and management style have performed well and are appropriate for the future.

The testimony received by the Commission was strongly in favor of preserving the value of the principal for future generations. Few citizens testifying were aware of, or recognized, the possibility that the Fund may not be fully inflation proofed in the future. When asked whether the

The Fund has earned \$6.6 billion

Since its inception, the Fund has earned roughly \$6.6 billion from investments. \$2.2 billion of this has gone toward payment of annual dividends to every qualified Alaskan resident. Of the remaining \$4.4 billion in earnings, \$1.645 billion has been deposited into the principal to offset inflation, \$1.264 billion has been deposited back into the Fund by the Legislature by special appropriation, \$635 million is currently being

held in the Earnings Reserve Account and \$232 million has been used for general governmental services.

While individual voters' opinions may have varied, testimony before the Commission indicates the most often expressed reasons for establishing the fund were:

- 1) to remove money from the income stream of the state,

dividend/inflation proofing priority should be reversed, the response was generally "yes," even if this change causes a reduction in dividend payments.

Keep the dividend program

The dividend program had very strong support from the people who testified. They presented a variety of reasons why this program is valuable. Some favored the dividend program because of the annual injection of capital into the Alaskan economy, others thought that the program is a fair method for the distribution of oil wealth, others thought it is an excellent method of removing funds from legislative overspending, and still others believed it is constitutionally mandated (it is not). They said the bush and rural communities depend heavily on the dividend for infusion of cash into their economies. Many said they would rather see a personal income tax than a reduction in dividends. A limited reduction in dividends is acceptable to fully inflation proof; otherwise, the public expects the dividends to continue. A number of people thought that capping the dividend was an appropriate step in the future.

Reduce government spending

Most people who testified concerning the level of government spending felt that it was excessive. Opposition to the use of the Fund's earnings for additional government spending was widespread. There was strong support for adequate funding for legitimate government services. However, the public believes that the current budgetary

-
- 2) to preserve a portion of the oil wealth for future generations and
 - 3) to develop an income source to support state government when oil revenues decrease.

In 1982 the Legislature enacted the statute that established the Dividend Fund within the General Fund. (Alaska Statute 43.23.045)

The Earnings Reserve Account was established as a separate account managed by the Permanent Fund Corporation. (Alaska Statute 37.13.145)

Each year, about 50 percent of the income from the Fund is divided by the number of qualified applicants and a dividend check is mailed to each person. The amount of this check for the year 1989 was \$876.13.

The remaining income is first reinvested into the principal to offset inflation; the amounts left over are held in the Earnings Reserve Account (ERA). The \$635 million in the ERA as of June 1989 has accumulated over several years.

level of approximately \$2.25 billion is too high. Few citizens were willing to specify which areas of state government should be reduced. Most agreed that it is up to the Legislature to determine the appropriate places to cut.

Opinions differ on educational endowment

The Commission has difficulty in summarizing public testimony about an educational endowment because of confusion surrounding it. While the educational community and some local governments strongly favored the concept of an educational endowment, similar support was not found in the general public's testimony. Opposition to the educational endowment was expressed in a variety of philosophical and political terms.

Many people do not think that the state should tamper with the prohibition against dedication of funds contained in the State Constitution. (Alaska State Constitution, Article IX, Section 7.) These people stressed that all potential uses of the earnings should compete equally with all other government demands or were concerned that dedicated revenue will result in less oversight of educational spending. Some people feared that providing additional funding for education will cause the cost of other government services to rise simply because of the availability of money. Others feared that any change to the constitutional provisions will open a floodgate of other demands on uses of the Fund's earnings.

Many people were critical due to current frustration with the education system. These people stated they were dissatisfied with the quality of education considering the

The Dividend Formula

The actual amount of income which is distributed as dividends is calculated based upon the following language:

Net income of the corporation shall be computed annually as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding any unrealized gains or losses. Income available for distribution equals 21 percent

of the net income of the corporation for the last five fiscal years, including the fiscal year just ended, but may not exceed the net income of the corporation for the fiscal year just ended plus the balance in the earnings reserve account . . .

-- A.S. 37.13.140

Once the income has been determined, the amount that goes to the dividend account is established

amount of money that is currently being spent. They were not convinced that a higher spending level or dedicated funding would improve the quality of education in the state.

Those favoring the educational endowment did so because they felt it was important to have a more stable and predictable state contribution to local education costs. Presentations by the Administration demonstrated that the educational endowment will provide only a portion of the money needed for education in the future. As currently structured, neither the Governor's nor the Legislature's bills will create as much money in real dollars as is currently being spent on education.

Don't alter Fund management

The public is satisfied with the current management of the Permanent Fund Corporation and the Board of Trustees. There was generally no demonstrated support for changing the investment philosophy of the fund. However, outside of those intimately involved with the Permanent Fund, few in Alaska have any in-depth knowledge about the specifics of the Fund's operation. Those who do have that knowledge, including members of the Fund's management team, have concerns that the treatment of unrealized gains and losses, definition of net income, and other accounting and investment-related subjects have a substantial effect on the size of the Fund and the distribution of earnings.

as follows:

... each year the commissioner [of revenue] shall transfer to the dividend fund 50 percent of the income of the Alaska permanent fund earned during the fiscal year ending on June 30 of the current year available for distribution.

--A.S. 43.23.045(b)

the dividend account is accomplished by a legislative appropriation. The amount appropriated is based on a five-year average which is intended to maintain a stable flow of dividends.

The actual transfer of funds to

Don't deduct from dividends

This year, the deductions from the dividend program and the purposes of those deductions were itemized on the dividend checks. All witnesses who mentioned this were upset by the subtraction from their check. While most did not complain about the deduction for the costs of administering the dividend program, the deductions for the hold harmless program, felon gate money, sexual offender programs and the Victims Compensation Fund were highly objectionable in the public's view.

Refine dividend qualifications

Public testimony was clearly in favor of restricting the dividend program to qualified residents. Some favored significantly increased residency requirements. However, a number of people expressed concern that efforts designed to prevent unqualified residents from receiving a dividend had the effect of denying dividends to some Alaskans who should receive them. Others were concerned that the additional reporting procedures imposed substantial burdens on all Alaskans and questioned whether these additional burdens and attendant administrative costs outweighed the benefits.

Hearing	Juneau, September 30, 1989
Locations	Barrow, October 7
	Anchorage, October 14
	Bethel, October 21
	Ketchikan, October 28
	Nome, November 4
	Kenai-Soldotna, November 11
	Fairbanks, November 18

Statewide hearings were:

Juneau, December 2
Anchorage, December 9

Findings and Recommendations

The legislation creating this Commission requires a report containing findings and recommendations. While not all members of the Commission may agree completely with all of the statements below, it is the consensus of the Commission that every recommendation addresses one or more issues critical to the future of the Fund and deserves consideration by the Governor and the Legislature.

What is the purpose of the Fund?

Article IX, Section 15 of the Alaska Constitution contains several key concepts:

- (1) At least 25% of designated mineral revenues shall be placed in a permanent fund,
- (2) The principal of the fund shall be used only for those income-producing investments specifically designated by law, and
- (3) All income from the Fund shall be deposited in the general fund unless otherwise provided by law.

The Commission examined the question of what is the purpose of the Permanent Fund, taking into account the public testimony, laws, past and current uses of Fund earnings, historical information and other relevant factors.

It is the Commission's conclusion that the Permanent Fund should continue to fulfill its constitutional purpose of creating a stable and growing stream of earnings to be appropriated by the Legislature. It is the Commission's unanimous opinion that this flexibility, as provided by the constitutional amendment creating the Permanent Fund, allows the Fund to best serve both current and future generations of Alaskans.

Plan now for the "fiscal gap"

The projected decline in Alaska oil production and the corresponding "fiscal gap" between spending and projected revenues was a major factor in the formation of this Commission.

The Commission received substantial testimony predicting a marked decline in Alaskan oil production within the next five years. There was no testimony or information presented contradicting these projections. While fluctuations in oil prices have and will continue to affect year to year revenues, it is highly unlikely that the revenue drop linked to the projected production decline could be offset by oil price increases. This is the basis of the projected difference between current spending and projected revenue that is often referred to as the "fiscal gap."

Public testimony was consistently strong in supporting a substantial cut in spending as the first and preferred method of dealing with this projected shortfall. Many members of the public suggested that, after spending has been reduced, income taxes should be a source of revenue. Some suggested reduction and a few proposed elimination of the dividend program.

While Alaska's economic future cannot be discussed without consideration of the role of the Fund, it must be noted that all of the Fund's real earnings are less than the current state budget. The Constitution prohibits spending the principal of the Fund for any purpose. Constitutionally the Legislature can appropriate all the earnings of the Fund without consideration for inflation proofing. However, if it is to be "permanent," the Fund must retain the value of the principal over time. To retain its value, the principal must be protected from the effects of inflation. Allowing inflation to erode the Fund would effectively produce the same result as spending the principal.

Unless spending levels are cut and/or additional revenues are raised, pressures may arise in the future to use earnings of the Permanent Fund to support state government, possibly even at the expense of the dividends and inflation proofing. The projected fiscal gap thus raises serious public policy issues that must be addressed by the Governor and the Legislature if the current uses of Permanent Fund earnings are to be maintained.

In the Commission's opinion, long-range planning is the only way to avoid having the resolution of these fiscal policy issues dramatically affect the economy or even precipitate a crisis. Planning combined with judicious changes in public policy should reduce the impact of these projections and avoid the wild

economic fluctuations we have historically endured. Unless the Governor and the Legislature address these issues now, a crisis appears inevitable. If the "fiscal gap" does not appear, it will be far easier to live with having planned for the worst than it would to respond to a fiscal crisis without the benefit of planning.

Recommendation: The Governor and the Legislature should initiate a process of long-term fiscal planning and take the necessary action to implement it.

Preserving the value of the Permanent Fund

The Constitution prohibits spending the principal of the Permanent Fund. The Constitution also specifies all investments of the Fund must be "income producing". State law invokes the "prudent investor rule" to assure reasonable and prudent investment of the funds. This is generally accepted as precluding investments in social or infrastructure programs. Statutes further define the type of investments allowed. All earnings of the Permanent Fund are subject to appropriation by the Legislature. The Legislature has provided through statute for the current dividend and inflation proofing programs.

According to expert testimony received, the method of inflation proofing adopted by the Legislature in 1982 will probably fail to protect the Fund principal at some point in the future. Under current practice, dividends are paid before any earnings are added back into the principal for inflation proofing. Since the dividend program formula requires more than 50% of Fund earnings, if the percentage of income needed to offset inflation exceeds 50%, there will be a shortfall in inflation proofing. The present statutes do not allow a shortfall occurring in one year to be recovered in following years nor do they allow for counting unrealized capital gains or losses toward inflation proofing. Failure to inflation proof the fund results in favoring current Alaskans over the future generations. Public testimony clearly favored the concept that current and future Alaskans should benefit equally from the Fund.

Recommendation: To resolve this issue the Legislature should reverse the priorities to give inflation proofing first call on earnings, recognizing that adjustments in the averaging periods and the definition of earnings must be made at the same time. The Commission considers this a necessary first step, but an incomplete solution. More comprehensive solutions are offered under the section "Stabilize the Real Earnings of the Fund".

Retain the Dividend Program

The public overwhelmingly stated that the current economic and social benefits of the dividend distribution program outweigh the need to use Fund earnings for government expenses. Even those who mentioned or suggested use of the earnings to offset falling revenues wanted government spending cut dramatically before any changes were made in the dividend program.

Recommendation: In retaining the dividend program, the Legislature should amend the statutes to assure it does not appropriate for the dividend program more than the real earnings of the Fund. Real earnings would equal total returns, including capital gains/losses if desired, less an amount sufficient to offset inflation. A payout floor, cumulative inflation proofing, modification of the averaging formulas or some alternative method should allow the payout to be averaged over time, thus producing a relatively predictable stream of funds.

Stabilize the Real Earnings of the Fund

Several individuals proposed changes intended to better define the investment goals and strategies of the Fund. Each proposal contained the consistent objective of creating a stable flow of real earnings from the Fund.

One proposal would change the management philosophy of the Fund to a payout rule similar to those used by a number of large endowment funds. This would establish a clear earnings goal for the long term, removing many of the current pressures to use short-term goals and allow a long-term investment policy.

Recommendation: The Commission urges the Governor and the Legislature to give timely consideration to the "payout rule" concept.

Another proposal advocated placing all resource revenues directly into the principal of the Permanent Fund and using the real earnings of the Fund as a substantial source of state revenues.

Recommendation: This innovative proposal warrants consideration by the Governor and the Legislature.

(A more detailed discussion of the payout rule and resource revenue proposals is contained in Appendices C and D.)

Disclose all uses of Fund earnings

The public indicated the dividend program should continue to be an equal distribution to all qualified Alaskans. Testimony was clear that reductions from the dividend checks, other than expenses directly associated with the administration of the dividend program within the Department of Revenue, are not acceptable. There was virtually no support for the "hold harmless", felon gate money, or sexual offender programs being funded from Fund earnings. Many individuals were upset to discover that reductions had been made in the past without being itemized on the check stub. Public testimony strongly suggested that reductions, other than inflation proofing and administrative expenses, should be eliminated.

Recommendation: All uses of the earnings of the Fund should be shown on the dividend check stub by listing the total amount of each use.

In summary

The Permanent Fund is only one element of Alaska's economy. For example, it is not, of itself, the answer to diminishing state revenues. The Fund must be considered and utilized in the context of a total revenue and spending plan. The Commission hopes that this report will help in shaping such a plan and that the public will continue to be recognized as a key participant in the process.

Appendix C

Protecting the Integrity of the Fund

AS 37.13.020 provides for the following goals for the Fund's investments: benefits for all generations of Alaskans, maintaining safety of the principal, maximizing total return, and providing for maximum use of disposable income. The statutes do not rank these goals in any order of priority and they tend, at times, to operate at cross purposes.

This leads to the following problems:

- 1) Existing state statutes provide that net income "Must be computed...in accordance with generally accepted accounting principles, excluding any unrealized gains or losses." This computation does not measure the total return on the Fund.
- 2) Subjecting each year's income to appropriation destroys the averaging concept that is called for in the statute.
- 3) Putting "income available for distribution" at a higher level than the average net income itself is fundamentally inconsistent.

These problems are combined with the difficulties in protecting the principal of the Fund from inflation under the present law.

This situation creates confusion over what the potential of the Fund to produce earnings really is. It increases the chance that Fund principal will not be preserved over time. It puts the Fund managers at a serious disadvantage in optimizing investments.

The problem to be solved is how to (1) preserve the real value of assets placed in the Permanent Fund, (2) pay out good, consistent earnings, and (3) not disrupt or distort investment decisions in order to achieve (1) and (2).

One solution is a payout rule, developed at Harvard in the 1960s and since adopted in one form or another by various endowments and trusts. In its simplest form, a payout rule involves spending or "paying out" each year a percentage of the market value of the assets. Market value is averaged over a number of years to provide stability in the "payout".

The percentage paid out should be no more than the long-term real earnings of the Fund on a total return basis; that is, the increase in the value of all funds under management, including interest, stock dividends, other cash receipts and net capital gains and losses, both realized and unrealized.

Determining the specific percentage for a "payout rule" would involve a decision on the risk-versus-return by the Legislature.

Advantages of the payout rule approach are that it is clear, simple and consistent with a long-term investment strategy.

Appendix D

Stabilizing a resource-based economy

The Constitution states that at least 25% of certain non-renewable resource revenues will be placed directly into the principal of the Permanent Fund. By statute, the Legislature increased this to 50% after December 1, 1979, for lease income and after February 15, 1980, for bonuses. The balance of all resource revenues flows directly into the general fund for appropriation by the Legislature.

The Commission heard substantive testimony regarding a proposal that would result in all revenues generated by non-renewable resources being deposited directly into the Permanent Fund. All earnings of the Fund would continue to be appropriable by the Legislature as under current statutes.

This would have the effect of stabilizing the flow of revenue into the general fund over time and thus would indirectly protect Alaska's economy from the wild boom and bust cycles historically tied to our non-renewable resources such as gold and oil. Given another "oil boom", such as we may see from the proposed gas pipeline, the Fund could conceivably grow to a size capable of producing earnings that could support a substantial portion or even all of state spending.

Until such time, the Fund earnings, renewable resource revenues, and taxes would continue to fund the state.

While this proposal would have been completely painless to implement prior to the current oil boom and the concurrent increases in state spending levels, it would be very difficult to implement now without a carefully considered and implemented transition plan. Such a plan would undoubtedly have to rely upon a combination of reducing spending and anticipating (waiting upon) a future "boom".

Alaskans would have to weigh their commitment to the long-term goal of stabilizing the economy of Alaska against the short-term difficulties in implementing this concept. This proposal also assumes non-renewable resources should benefit both current residents and future generations.

A successful transition to this concept would remove substantial elements of doubt and uncertainty regarding future state revenues and the health of Alaska's economy.